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In the Supreme Court of the United States

OCTOBER TERM, 1984

COMMODITY FUTURES TRADING COMMISSION, PETITIONER

v.

GARY WEINTRAUB, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

REPLY BRIEF FOR THE COMMODITY FUTURES TRADING COMMISSION

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18pp

TABLE OF AUTHORITIES

Page

Cases:

Page

Cases—Continued:

Statutes and rules:

Page

Statutes and rules—Continued:

Page

Page

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1. Respondents argue (Resp. Br. 12-17) that the Bankruptcy Code and cases interpreting earlier bankruptcy statutes preclude the trustee's control of a debtor corporation's attorney-client privilege. This argument is plainly without merit. Section 542(e) of the Code (11 U.S.C.) authorizes the court to compel "an attorney, accountant, or other person that holds recorded information * * * relating to the debtor's property or financial affairs" to disclose that information to the trustee, "[s]ubject to any applicable privilege." This provision was designed to limit the ability of attorneys and others to withhold relevant information, not to expand it. See 4 *Collier on Bankruptcy* ¶ 542.06, at 542-21 (L. King 15th ed. 1984); S. Rep. 95-989, 95th Cong., 2d Sess. 84 (1978); H.R. Rep. 95-595, 95th Cong., 1st Sess. 369-370 (1977). Section 542(e) does not by its terms specify

whether the debtor's attorney-client privilege is "applicable" to a trustee's demand for information.[1] Congress quite clearly left this question -- and not, as respondents claim (Resp. Br. 14 n.11), merely the determination of whether particular documents fall within the privilege — to the courts:

> The extent to which the attorney client privilege is valid against the trustee is unclear under current law and is left to be determined by the courts on a case by case basis.

124 Cong. Rec. 32400 (1978) (remarks of Rep. Edwards); *id.* at 33999 (remarks of Sen. DeConcini).[2]

Nor do the hoary cases cited by respondents (Resp. Br. 16-17) support their position.[3] *In re O'Donohoe,* 18 F. Cas. 587 (D. Me. 1869) (No. 10,435), and *In re Krueger,* 14 F. Cas. 870 (D. Mass. 1872) (No. 7,942), addressed the applicability not of the *bankrupt's* attorney-client privilege, but of the privilege of persons who had entered into contracts or

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[1]Allowing the trustee, as management of the corporate debtor, control over the debtor's attorney-client privilege would not, as respondents argue (Resp. Br. 14-15), render the statutory language a nullity. Information that is subject to the debtor's own attorney-client privilege is not denied the trustee, because that privilege is not "applicable" to him. Privileges of parties other than the debtor, such as creditors who have information relating to the debtor, would still be "applicable" as against the trustee. Moreover, under respondents' interpretation, the term "applicable" would be surplusage, for Section 542(e) already gives the trustee free access to nonprivileged recorded information.

[2]Representative Edwards and Senator DeConcini were the floor managers for the Bankruptcy Reform Act of 1978, 11 U.S.C. 101 *et seq.*

[3]Similarly, 5 H. Remington, *A Treatise on the Bankruptcy Law of the United States* § 2003 (15th ed. 1953), relied on by respondents (Resp. Br. 15), does not address the question of who controls a debtor corporation's attorney-client privilege. Nor does the nonassignability of an individual's privilege (see *id.* at 20 n.16) support respondents' argument: there is no question that successor management succeeds to control of a corporation's privilege (Pet. Br. 11).

had other business dealings with the bankrupt. Of course we are not seeking to grant the trustee control over the privilege of any entity other than the corporate debtor. *In re Aspinwall,* 2 F. Cas. 64 (S.D.N.Y. 1874) (No. 591), appears to involve an individual debtor, not a corporation, and thus raises different concerns (see pages 8-9, *infra*). *In re Teuthorn,* 5 Am. Bankr. Rep. 767 (D. Mass. 1901), which also appears to involve an individual debtor, prohibits an attorney who had represented the debtor in the bankruptcy proceeding from later representing the trustee in the same proceeding, a situation inapposite to the facts of the instant case. Before 1978, the only reported authority of which we are aware held that the trustee in bankruptcy does succeed to the debtor corporation's attorney-client privilege. *In re Amjoe, Inc.,* 11 Collier Bankr. Cas. (MB) 45 (Bankr. M.D. Fla. 1976). In any event, whatever the law might have been under the earlier statutes,[4] Congress plainly considered the question an open one with respect to the present Bankruptcy Code.

2. Respondents argue next (Resp. Br. 18-26) that the trustee of a corporation in bankruptcy does not possess the

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[4]Respondents assert (Resp. Br. 16) that "[t]he laws governing bankruptcy examinations have not been materially changed since 1867." But our position rests not merely on the provisions governing examinations, but more fundamentally on the trustee's management powers. In this respect, the law has changed over the past 118 years to grant the trustee greater authority over the affairs of the debtor. See 4 *Collier on Bankruptcy* ¶ 721.02, at 721-2 (L. King 15th ed. 1984).

Respondents' reliance (Resp. Br. 15) on Section 21(a) of the Bankruptcy Act of 1898, ch. 541, 30 Stat. 552, which permitted the trustee to override assertions of the spousal privilege, is misplaced. Consistent with its preference for judicial resolution of privilege issues, Congress did not carry forward the statutory limitation on the spousal privilege in the new Bankruptcy Code. See S. Rep. 95-989, *supra,* at 43; H.R. Rep. 95-595, *supra,* at 332; Bankr. R. 2004 advisory committee note, 9017. Moreover, provisions relating to personal privileges are irrelevant to whether the trustee has authority over a debtor corporation's attorney-client privilege.

management powers and duties necessary to be accorded control of the corporation's attorney-client privilege. Respondents do not dispute that control of a corporation's attorney-client privilege rests with its present management (see Pet. Br. 9-12). Nor do they take direct issue (except to say, erroneously, that our formulation assumes the result, Resp. Br. 21 n.18) with the necessary corollary that the question in this case is who, under the Bankruptcy Code, manages a debtor corporation (see Pet. Br. 22). When the powers and responsibilities of the trustee and of the officers and directors of a corporation in bankruptcy are compared, the conclusion is inescapable that it is the trustee who now constitutes management and who must therefore have control over the attorney-client privilege.[5]

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[5]Our "management" argument does not, as respondents suggest (Resp. Br. 21 n.17), "collapse[]" into the alternative argument that control over the privilege constitutes intangible property encompassed within the bankruptcy estate (see Pet. Br. 22 n.38). We do not contend that the trustee controls the privilege simply by virtue of his position as representative of the estate (see 11 U.S.C. 323(a)), but rather because of the full complex of rights and responsibilities that fall to the trustee under the Code (see Pet. Br. 12-24), and because the debtor's officers and directors no longer play a role in managing the corporation (see *id.* at 18, 25). Had Congress intended its enumeration in Section 541 of property included in the estate to limit the trustee's authority over the debtor's privileges, it would have said so. Cf. *Ohio* v. *Kovaks,* No. 83-1020 (Jan. 9, 1985), slip op. 5 & n.4. It would make little sense to suppose that the same Congress that explicitly left the privilege question to the courts (see page 2, *supra*) would elsewhere have, as respondents contend, conclusively rejected the trustee's ability to control the privilege.

Respondents also are wrong in claiming support for their position (Resp. Br. 43-44) in *Butner* v. *United States,* 440 U.S. 48 (1979). The Court's reliance in *Butner* on state nonbankruptcy law suggests precisely the approach we have taken here: control over a bankrupt's attorney-client privilege should rest with the party in a position most closely analogous to corporate management, which controls the privilege outside of bankruptcy. Respondents' contention that control by the trustee would skew incentives toward bankruptcy improperly assumes

a. The trustee's extensive management powers are described in our opening brief (at 12-21, 25 n.42). In summary, the trustee in a commodity broker liquidation always operates the debtor's business;[6] a liquidation trustee succeeds to the corporation's causes of action; he must investigate the debtor's financial affairs, including the conduct of former management; and he may enter into transactions concerning property of the estate. By contrast, the officers and directors of the debtor no longer play a part in managing the corporation's affairs. Whatever limited nonmanagerial role, if any, may be left for former management after a trustee has been appointed,[7] it plainly is no longer in control of the business.

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that creditors would be able to obtain privileged information and use it for their own benefit, thereby reducing the value of the estate (see Resp. Br. 43). Our position is not, as respondents contend (*id.* at 44), that "creditors should have access in bankruptcy to privileged attorney-client confidences," but rather that the trustee should have control over the privilege and be able to allow third parties access to privileged information when it is in the best interests of the estate as a whole (see 11 U.S.C. 323(a), 704). Hence, the trustee's fiduciary responsibility to maximize the value of the estate would preclude the manipulation by creditors that respondents envision. Moreover, the mere filing of a petition does not ensure that an order for relief will be entered (see 11 U.S.C. 303(h)), and the Code already provides sufficient deterrents, such as punitive damages, against creditors who might be tempted to file an involuntary petition in bad faith (see 11 U.S.C. 303(i)(2)).

[6]Trustees in other liquidations may operate the debtor's business with approval of the court. Respondents' suggestion (Resp. Br. 25 n.21) that the Code's special provisions for bankrupt commodity brokers give less management authority to trustees than that possessed by officers and directors outside of bankruptcy is incorrect. The provisions of the Code were designed to ensure that the trustee would be limited by the same constraints imposed on the management of commodity brokers outside bankruptcy. See Pet. Br. 21 n.36.

[7]Shareholders, like creditors, may be represented by official or unofficial committees (and of course, in all cases, ultimately by the trustee himself). See 11 U.S.C. 323, 705, 1102, 1103. In reorganization, officers of a corporate debtor not in possession may have standing to be heard on behalf of shareholders on certain questions that may affect their

b. The trustee's responsibilities also are similar to those of management outside bankruptcy (see Pet. Br. 16-17). Contrary to respondents' contention (Resp. Br. 22 n.20), management of a corporation not in bankruptcy does owe fiduciary duties to the corporation's creditors. See *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971); *Pepper* v. *Litton*, 308 U.S. 295, 306-307 (1939) (corporate director's "fiduciary obligation * * * [is] 'designed for the protection of the entire community of interests in the corporation — creditors as well as stockholders' ") (citation omitted); see also *McCandless* v. *Furlaud*, 296 U.S. 140, 156-157 (1935); *Southern Pac.* v. *Bogert*, 250 U.S. 483, 492 (1919); *Jackson* v. *Ludeiing*, 88 U.S. (21 Wall.) 616, 624-625 (1874). These duties require management to pay creditors before shareholders, to refrain from engaging in fraudulent conveyances, and to administer an insolvent corporation's assets primarily for the benefit of its creditors. See *McDonald* v. *Williams*, 174 U.S. 397, 404 (1899); *Hollins* v. *Brierfield Coal & Iron Co.*, 150 U.S. 371, 383 (1893); *Wood* v. *Dummer*, 30 F. Cas. 435 (C.C.D. Me. 1824) (No. 17,944) (Story, J.); *Singer* v. *Hutchinson*, 183 Ill. 606, 619, 56 N.E. 388, 392-393 (1900); 15A W. Fletcher, *Cyclopedia of the Law of Private Corporations* § 7369 (rev. ed. 1981); Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 Harv. L. Rev. 505

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particular interests in a case (see Resp. Br. 19 n.15). But this right to be heard must not be confused with the right to exercise managerial control over the corporation, which passes exclusively to the trustee. Cf. *Zeleznik* v. *Grand Riviera Theater Co.*, 128 F.2d 533, 536 (6th Cir. 1942) (shareholders' derivative action may not be brought without prior demand on bankruptcy trustee). It is the trustee who, by virtue of his management of the debtor, requires control over the privilege and who, by virtue of his fiduciary responsibilities, can be expected to exercise that control in the best interests of all concerned. Conversely, former management, whose own communications are normally at issue, neither requires control over the privilege nor is in any position to represent the best interests of either the shareholders or the creditors.

(1977).[8] The fiduciary responsibilities of corporate management to creditors have to a large extent been codified in most states' corporation laws. See, *e.g.*, Model Business Corp. Act §§ 45, 98 (1981); Ill. Ann. Stat. ch. 32, §§ 9.10(c), 12.05(c) (Smith-Hurd Supp. 1984); N.Y. Bus. Corp. Law §§ 510, 1005, 1210 (McKinney 1963 & Supp. 1984-1985); see also *In re MortgageAmerica Corp.*, 714 F.2d 1266, 1269-1271 (5th Cir. 1983); 15A W. Fletcher, *supra*, § 7385.[9]

Respondents also make much of the fact that shareholders possess only a residual claim to a bankrupt estate, recovering only after all creditors are paid in full (Resp. Br.

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[8]In view of the duties owed to creditors by an insolvent corporation (whether or not it is in bankruptcy), the creditors' interest in the corporation is best understood, for present purposes, as an ownership interest. See generally *McDonald* v. *Williams*, *supra*; Baird & Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. Chi. L. Rev. 97, 112-113 & n.52 (1984); Note, *Creditors' Derivative Suits on Behalf of Solvent Corporations*, 88 Yale L.J. 1299, 1304-1305 (1979). In commodity broker bankruptcies in particular, most claims are brought by customers, who own the funds they have placed with the broker (see Pet. Br. 20 n.32). Accordingly, the trustee acts on behalf of all the ownership interests in the corporate debtor, just as does management outside bankruptcy.

[9]We explained in our opening brief (at 20-21 & nn.32, 36, 37) that officers of commodity brokers owe fiduciary duties to their customers, who constitute most of a commodity firm's creditors. An administrative law judge has recently issued an initial decision concluding that Gary Weintraub, the attorney whose assertion of the privilege is at issue in this case, did not violate the antifraud provisions of the Commodity Exchange Act, 7 U.S.C. 6b(A), because he did not have actual or constructive knowledge of Frank McGhee's illegal activities and did not, as corporate counsel, owe a duty to the firm's customers to discover those activities. *In re Weintraub*, CFTC No. 83-1 (Jan. 7, 1985) (a copy of this decision has been lodged with the Clerk). In dicta, the administrative law judge limited the personal liability of an officer of a commodity broker to cases where he has knowledge of the fraud in question (slip op. 17-18). This decision, which has been appealed to the full Commodity Futures Trading Commission, does not affect the instant case.

22). But exactly the same is true of an insolvent corporation not in bankruptcy. See, *e.g., Sanger* v. *Upton,* 91 U.S. 56, 60 (1875); *Citizens' National Bank* v. *Greene,* 258 Ky. 373, 80 S.W.2d 6, 7 (1935); *American State Bank* v. *Jones,* 184 Minn. 498, 239 N.W. 144, 146 (1931); 15A W. Fletcher, *supra,* § 7417, at 137 ("Stockholders of an insolvent corporation cannot participate in the distribution of its assets until the claims of creditors are paid. * * * [T]he only interest a stockholder has * * * is his interest in any surplus over and above what is required to pay its depositors and creditors."). [10] The interest of shareholders in liquidation is thus identical to that of shareholders of insolvent corporations outside of bankruptcy — they desire to maximize the value of the estate. When the trustee determines that waiver of the debtor's privilege may increase the assets of the estate, he is acting consistently with the best interests of the debtor's shareholders as well as its creditors. [11] In making this judgment the trustee is bound by the strictest of fiduciary duties. See *Mosser* v. *Darrow,* 341 U.S. 267, 271 (1951); see also *Bayliss* v. *Rood,* 424 F.2d 142, 146 (4th Cir. 1970).

3. Respondents claim (Resp. Br. 7, 26-30, 44-46) that our position would compel the result that trustees could waive the privilege of individual debtors as well as that of corporate bankrupts. This question simply is not presented and need not be decided by the Court. See generally *Upjohn Co.* v. *United States,* 449 U.S. 383, 396-397 (1981). [12] In any event, there is a significant difference between individuals

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[10] See also Baird & Jackson, *supra,* 51 U. Chi. L. Rev. at 105 nn.28-29, 112-113 & n.52.

[11] Similarly, in reorganization, the trustee's obligations are no different from those of the officers and directors when the debtor is permitted to remain in possession. See 11 U.S.C. 1107; *Wolf* v. *Weinstein,* 372 U.S. 633, 649-650 (1963); S. Rep. 95-989, *supra,* at 116.

[12] The debtor here was incorporated, as are approximately 90% of all commodity brokers.

and corporations with respect to the attorney-client privilege. An individual's privilege is personal to him. [13] Unlike a corporation, there is no "management" that controls an individual's privilege. Accordingly, the fact that a trustee may in some circumstances oversee the affairs of an individual debtor (but see 11 U.S.C. 1304(b)) does not necessarily mean that he should obtain control over the privilege. This distinction is neither irrational nor in conflict with the Bankruptcy Code [14] — it follows naturally from the differences under nonbankruptcy law between corporations and individuals. Cf. *United States* v. *White,* 322 U.S. 694, 699-700 (1944); see generally *In re Silvio De Lindegg Ocean Developments of America, Inc.,* 27 Bankr. 28 (Bankr. S.D. Fla. 1982).

4. Finally, respondents argue (Resp. Br. 30-42) that vesting control over the privilege in the trustee will not serve any beneficial policy but rather will only chill attorney-client

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[13] This is true even where the individual operates a sole proprietorship. A sole proprietorship is not an artificial entity; it "has no legal existence apart from its owner." *In re Grand Jury Empanelled February 14, 1978,* 597 F.2d 851, 859 (3d Cir. 1979).

[14] Respondents are incorrect in arguing (Resp. Br. 28-29) that the Bankruptcy Code does not differentiate in relevant respects between individual and corporate debtors. Unlike an individual, a corporation has no function distinct from its business existence, and thus for practical purposes a corporation in bankruptcy merges entirely into the estate, which encompasses all corporate assets and earnings and is controlled by the trustee (see Pet. Br. 13-14). In contrast, certain assets and post-petition earnings of an individual debtor are not part of the estate and hence not subject to the trustee's control (see 11 U.S.C. 522, 541(a)(6)). Moreover, individuals may not be discharged from certain debts, such as those connected with their frauds (see 11 U.S.C. 523, 727), while a corporation in reorganization obtains a complete discharge of such potential liability upon confirmation of a plan (see 11 U.S.C. 1141(d)); a corporation undergoing liquidation may not be discharged (see 11 U.S.C. 727(a)(1)), but becomes an empty shell without future viability (see *Ohio* v. *Kovaks,* slip op. 2 (O'Connor, J., concurring)).

communications.[15] Respondents' solution, to allow former management to block effective inquiry into its own wrongdoing, makes little sense indeed. Such a rule would serve only the personal interests of former management; it would in no way further the interests of the estate's beneficiaries. The trustee is a court-supervised fiduciary charged with maximizing the value of the estate (11 U.S.C. 323, 704(1)). He is surely in the best position to make decisions that will be fair to all of the interested parties — creditors and equityholders — as a group.[16] Regardless of who has appointed him, the trustee must act in the best interests of the estate as a whole. Waivers contrary to the interests of the estate may be challenged in bankruptcy court.[17] And, as we explained earlier (Pet. Br. 10-11, 30), the potential chilling effect here is identical to that which exists outside bankruptcy: an individual always runs the risk that present or successor management may waive the privilege with respect to his own communications to the corporation's attorney. In view of the trustee's fiduciary responsibilities, there is no

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[15]Respondents erroneously equate the trustee's power over the privilege with its abrogation. But the trustee's control over the privilege no more guarantees that it will be waived than does management's identical authority outside of bankruptcy. The question here, unlike in *Upjohn Co.* v. *United States, supra,* is not the existence or the scope of the privilege, but simply which natural person should be authorized to control it for the entity.

[16]See generally Baird & Jackson, *supra.*

[17]Respondents challenged below only the trustee's power to waive the debtor's privilege, not whether the waiver here was in the best interests of the estate. Moreover, their belated challenge is addressed to the wrong forum: challenges to the conduct of bankruptcy trustees should be raised in the bankruptcy court, not in a subpoena enforcement court (see Pet. Br. 36 n.63). In any event, contrary to respondents' speculations (Resp. Br. 2-3 & n.3), the trustee, by virtue of his own investigation and the adversary actions he had commenced against insiders, was in a position to make an informed judgment at the time he executed the waiver (see Pet. Br. 4-5 n.8).

reason to carve out a special rule for bankruptcy, and indeed every reason not to do so.[18]

For the foregoing reasons and those presented in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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[18]Respondents' speculation (Resp. Br. 32-35) that the trustee has no need of privileged information is unfounded. The debtor's attorney is often the only practical source of information to which the trustee must have access if he is to carry out his management functions. Denying such information to the trustee would only increase the expenses charged against the estate and decrease the assets included within it. See Brief of John K. Notz, Jr. at 4.